Jahnavi Prabhakar
Economist

Bonds Wrap

Global yields softened further in Jul'24. US 10Y yield declined sharply. Fed kept rates on hold and dovish commentary by Fed Chair signaled rate cut likelihood as early as Sep'24. This was supported by softer PCE price index which came in line with expectations. On the domestic front, India's 10Y yield eased. Notably, RBI has recently restricted foreign ownership access towards 10&14Y securities, with more demand shifting towards the securities leading up to 10 years. Going forward, the 10Y yield is expected to trade in the range of 6.85%-6.95% in Aug'24, with risk evenly balanced. The attention will turn towards the upcoming monetary policy meeting to provide more guidance on inflation outlook.

Movement in global yields in Jul'24:

- There was significant variation in movement in global yields in Jul'24 across global economies. While 10Y yield in China fell by 6bps, yields in US and UK was down by 37bps and 20bps respectively.

Table 1. 10Y yield movement globally

Countries	10Y sovereign yield, 28 June 2024	10Y sovereign yield, 31 July 2024	Change in bps (MoM)
Japan	1.06	1.06	0
China	2.21	2.15	-6
India	**7.01**	6.93	-8
Indonesia	7.07	6.90	-17
UK	4.17	3.97	-20
Korea	3.26	3.06	-20
Germany	2.50	2.30	-20
Singapore	3.20	2.87	-33
US	**4.40**	**4.03**	-37

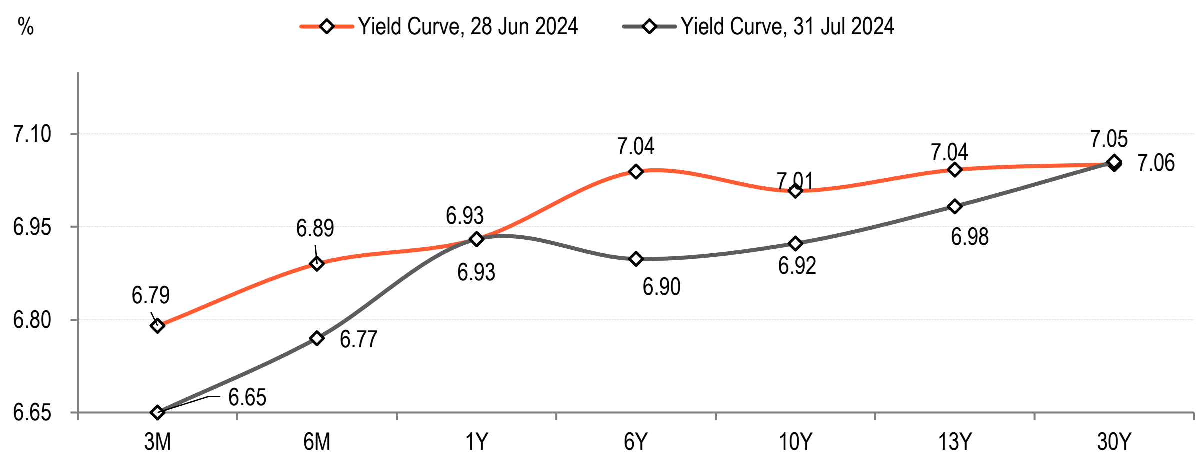
Source: Bloomberg, Bank of Baroda Research

- US 10Y yields ended lower by 37bps in Jul'24. US PCE price index which is Fed's preferred gauge of inflation eased to 2.5% in Jun'24 from 2.6% in May'24. Inflation in gasoline and other energy goods was down by 3.5% in Jul'24 (3.4% in May'24). Moreover, prices of transportation services was down for the 3rd straight month to 2.5% from 2.6% in May'24. Core PCE inflation (exl food and energy components) remained steady at 2.6% injun'24. The JOLTS report showed that there were 8.18mn job openings in Jun'24 from 8.23mn in May'24. US GDP in Q2CY24 advanced sequentially by 2.8% on an annualized QoQ basis from 1.4% in Q1CY24 driven by higher consumer spending, non-residential fixed investment and private inventory investment. Against this backdrop, US Fed in its recent policy meeting unanimously voted to keep the current benchmark rates of 5.25-5.5% steady at the current juncture, in line with expectations. It hinted about the progress that has been made towards nearing the Central bank's target of 2%. Fed Chair stated that 'reduction in policy rate could be on table soon as next meeting in September'. According to the CME FedWatch Tool, the probability of a 25bps rate cut stands at 86.5% for Sep'24.

- Following a 25bps rate cut in Jun'24, ECB left rates unchanged in Jul'24 and highlighted they will remain data dependent. The committee noted that they will keep rate restrictive as long as needed. On inflation front, prices in Eurozone climbed up 2.65 in Jul'24 from 2.5% in Jun'24. This makes it complicated for ECB to lower rates again in the next meet scheduled in Sep'24 given the recent uptick in inflation.
- In the UK, BoE reduced the rates for the first time in 4-years. With the 25bps rate cut, the policy rates currently stands at 5% with a vote of 5-4. This is expected to provide relief to the households and support the housing market as the mortgage costs is expected to be lower.
- In a policy divergence from other Central Bank, BoJ as anticipated has hiked policy rate (by 15bps) for the 2nd time in over 17-years moving away from the ultra-loose monetary policy. Additionally, it was also announced to lower the bond purchasing programme by half to Yen 3tn/month by Q1CY26.

India's 10Y yield eased by 8bps and traded in the range of 6.91-7.12% in Jul'24 from 6.90%-7.04% in Jun'24. In Jul'24, 10Y yield touched the 6.91% mark, lowest in over 28-months given the favorable supply-demand dynamics. Additionally the government in the budget had reduced its gross borrowing to Rs 14 lakh crore as it plans to remains fiscally prudent with fiscal deficit target of 4.9% of GDP.

Figure 1: Movement in India's yield curve



Source: Bloomberg, Bank of Baroda Research

The short end part of the curve has softened. The spread between 3M and 30Y edged up to 40bps in Jul'24 from 26bps in Jun'24, given the long-end part of the curve is broadly stable.

What auctions in the domestic market reflect?

In Jul'24, cut off yields for the 10Y paper of both state and Centre moderated suggesting strong demand conditions. Even the cut-off yield for short term paper eased.

Table 2. Cost of borrowing

Type of Papers	Cut off yield (%)	
	Jun'24	Jul'24
Central Govt.	7.06	6.96
SDL	7.32	7.32
91-day Tbill	6.80	6.67
182-day Tbill	6.92	6.79
364-day Tbill	6.96	6.80

Source: Bank of Baroda Research | Note: Average cut off yield is taken to arrive at borrowing cost|Auction dates might differ

Liquidity situation:

- Average system liquidity surplus in Jul’24 turned out to be Rs 1,02,718 crore in Jul’24 from a deficit of Rs 54,660 crore in Jun’24. However, it must also be noted that there has been some fall in banking system liquidity surplus (defined as incremental deposit-incremental credit-incremental investment) to Rs. 70,950 crores (as of 12 Jul 2024) compared with Rs. 2.71 lakh crore in Jun’24. Going forward, with some easing of credit growth, liquidity will continue to get some support in the near term.

Outlook on 10Y yield for the next 30days:

- *India’s 10Y yield is expected to trade in the range of 6.85-6.95% in the current month*. RBI recently had imposed restriction on foreign investor’s towards the purchase of 14-year and 30-year government bonds. The objective is to possibly keep the demand concentrated in the short term securities leading to 10-year bond.
- The focus will shift towards upcoming RBI monetary policy meet wherein MPC is expected to keep rates on hold. However, any revision in inflation projection will be closely monitored given the recent rise in global crude prices amidst growing geopolitical tension in Middle East.
- The 10Y yield curve has been supported by RBI’s liquidity management strategy through VRRR.

For further details about this publication, please contact:

Economics Research Department
Bank of Baroda
chief.economist@bankofbaroda.com